

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 98-0091, 98-0154, 00-0275
Individual Income Tax
For the Years 1994 and 1995
Corporate Income Tax
For the Years 1991, 1992, 1993, 1994, and 1995
Sales and Use Tax
For the Years 1994, 1995, and 1996

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ISSUE

I. Sales and Use Tax—Sales to out-of-state residents who picked up the merchandise in Indiana

Authority: IC 6-8.1-5-1(b); IC 6-2.5-2-1; IC 6-2.5-9-3; 45 IAC 2.2-5-54.

Taxpayer protests the assessment of sales tax on sales made to Kentucky customers who picked up the merchandise at Taxpayer's Indiana location.

II. Sales and Use Tax—Unreported cash sales unsubstantiated by records

Authority: IC 6-8.1-5-1(b); IC 6-8.1-5-4; IC 6-8.1-5-1(a).

Taxpayer protests the assessment of sales tax due on unreported cash sales and the Department's calculation of that amount of sales tax due.

III. Corporate Income Tax—Unreported Cash Sales

Authority: IC 6-3-4-1(3); 45 IAC 3.1-1-67.

Taxpayer protests the assessment of additional income based on unreported cash sales.

IV. Individual Income Tax—Unreported Cash Sales

Authority: IC 6-3-4-1(1).

Taxpayer protests the over-recognition of pass-through income from S-corporation.

STATEMENT OF FACTS

Taxpayer operates a retail store in Indiana. Sales are made over-the-counter, by delivery, and by shipment in interstate commerce using UPS. Some Kentucky customers bought and picked up merchandise at Taxpayer's Indiana retail store. Taxpayer had registered with Kentucky as a retail merchant and was collecting and remitting sales tax to Kentucky on these Kentucky customers. The Department assessed Indiana sales tax on these sales. Taxpayer insisted these sales were exempt as sales in interstate commerce.

Taxpayer sold merchandise across-the-counter at its Indiana retail store. These are termed "cash sales." The sales were recorded on hand-written sales tickets that were not pre-numbered. These sales were rung on the cash register—which kept a tape. At the end of the day, the sales were zeroed out. Taxpayer kept the revenues in a safe and made bank deposits on a sporadic basis—varying from weekly to monthly to quarterly. The deposits were not the true amount of revenues generated by sales because Taxpayer made payouts from the register and spent money from the safe. This fact was stated by a former bookkeeper employed by Taxpayer. Taxpayer had destroyed the hand-written sales tickets and the cash register tapes for the audit period, possibly by shredding the records. The Department estimated sales by taking an average of sales made during a two-month post-assessment sample period. Taxpayer knew an active sample was being conducted—yet the hand-written sales tickets and register tapes for the sample were destroyed. The Department, using the summary tape from the register, calculated the average sales amount to be \$17.57. The Department then multiplied this average by the number of sales tickets that had been used. Taxpayer had purchased a supply of sales tickets from a local printer. The Department subtracted 600 special order sales tickets it already had reviewed. Taxpayer is protesting the Department's calculation of the number of sale tickets used. Taxpayer has agreed to the average sale amount of \$17.57.

The assessment of additional sales tax due triggered an increase in the amount of revenue generated by Taxpayer's business. The Department adjusted Taxpayer's corporate income tax return and Taxpayer's individual income tax return.

I. Sales and Use Tax—Sales to out-of-state residents who picked up the merchandise in Indiana

DISCUSSION

All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b). IC 6-2.5-2-1 imposes a sales tax on retail transactions made in Indiana. A person who acquires property in a retail transaction conducted in Indiana is liable for the sales tax and is required to pay it to the retail merchant. *Id.* The retail merchant is required to collect the tax as an agent for the state. *Id.* If a retail merchant fails to collect or remit sales tax, the merchant and/or the responsible officers personally are liable to pay the sales tax it had a duty to collect. IC 6-2.5-9-3. 45 IAC 2.2-5-54 states that sales of tangible personal property delivered in Indiana to a purchaser are subject to sales tax.

Taxpayer had a duty to collect and remit sales tax for over-the-counter sales made to customers from Kentucky who physically purchased and picked up their merchandise at Taxpayer's Indiana

retail store. Taxpayer's contradictory arguments are not relevant. Taxpayer claimed it collected and remitted sales tax to Kentucky. Taxpayer alternatively argued that the over-the-counter sales to purchasers from Kentucky were exempt from sales tax because they were made in interstate commerce. The statutes and regulation cited above are clear—Taxpayer had a duty to collect and remit sales tax to Indiana for sales made and delivered in Indiana.

FINDING

For the reasons named above, Taxpayer's protest is denied.

II. Sales and Use Tax—Unreported cash sales unsubstantiated by records

DISCUSSION

All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b). IC 6-8.1-5-4 affirmatively requires a taxpayer to keep books and records so that the Department can review the documents to determine the amount of a taxpayer's liability for applicable taxes. The records required to be maintained include invoices, register tapes, receipts, and canceled checks. *Id.* Taxpayer created these documents; yet it affirmatively destroyed these records. If the Department reasonably believes that a taxpayer has not reported the proper amount of tax due, IC 6-8.1-5-1(a) mandates the Department to make a proposed assessment of the amount of unpaid tax on the basis of the best information available to the Department.

Despite the fact that Taxpayer had not maintained the records to substantiate cash sales for 1994, 1995, and 1996, the auditor attempted to compensate for this by estimating sales based on a sample period. Because Taxpayer and the Department agreed on a two-month post-assessment sample period, Taxpayer was on notice that an attempt to estimate sales amounts and sales volumes was being created. Taxpayer confirmed to the Department that it would maintain records so that these calculations could be made. Yet Taxpayer chose to destroy these records. Having done so, the Department made a best estimate of the average sales amount and the number of sales with the information it had available. Taxpayer has agreed that \$17.57 is the average sale amount. At issue is the number of sales. The Department based the number of sales on the number of sales tickets purchased and used. Subtracting the 600 sales that the Department could substantiate, that leaves the remainder of the sales tickets for which there has been no accounting. Taxpayer has stated that the sales tickets were used for phone messages and for other general purposes. However, this statement requires a substantiation of the number of tickets used for sales and the number not used for sales. Barring positive evidence to rebut the use of the sales tickets for purposes other than sales, the Department's computation of the number of sales tickets used is the best information available to the Department.

FINDING

For the reasons stated above, Taxpayer's protest is denied.

III. Corporate Income Tax—Unreported Cash Sales

DISCUSSION

The assessment of additional sales tax due based on the calculation of unreported cash sales triggers an increase in the revenues earned by Taxpayer. Taxpayer's business is incorporated as an S-corporation. IC 6-3-4-1(3) requires all corporations with gross income from an Indiana source to file an income tax return. 45 IAC 3.1-1-67 requires an S-corporation to file an IT-20S. Annual returns must be filed by S-corporations incorporated in Indiana or having income from Indiana sources. *Id.* Since the Department assessed unreported cash sales and since the Department upheld the sales tax assessment on those sales, the revenue is reportable for corporate income tax purposes.

FINDING

For the reasons stated above, Taxpayer's protest is denied.

IV. Individual Income Tax—Unreported Cash Sales

DISCUSSION

Income earned by an S-corporation is passed through to the shareholders to be taxed on their individual income tax returns. Taxpayer's business is incorporated as an S-corporation, which means that the income earned by an S-corporation is considered to be income earned by the shareholders. IC 6-3-4-1(1) requires each Indiana resident to file an annual individual income tax return. Since the Department assessed unreported cash sales and since the Department upheld the sales tax assessment on those sales, the revenue is reportable for individual income tax purposes.

FINDING

For the reasons stated above, Taxpayer's protest is denied.